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2000 Annual Report

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HELENA, MONTANA 596

Montana Lottery

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Director's Message

Director Gerald J. (Jerry) LaChere

The Montana Lottery is pleased to present its Fiscal Year 2000 Annual Report. This teport contains the Lottery's audited financial statements and information about the Lottery's products.

Fiscal Year 2000 was highlighted by a generous increase in our total Scratch ticket revenue. Scratch revenue increased to $9,060,981, which is an increase of almost 24 percent over Fiscal Year 1999 revenue of $7,314,666.

Our on-line revenue picture was not as positive. Although Powerball revenue continues to lead our product sales, at $13.1 million, revenue decreased in fiscal year 2000 by almost 10 percent. Montana Cash and Wild Card each posted a small decrease of three percent and two percent, respectively. Cash4Life, a small part of our total revenue, decreased almost 21 percent, to $773,469. Our overall on–line revenue decreased almost nine percent. The on-line decreases are most likely a result of a number of factors, including a phenomenon called "Jackpot Fatigue" where players anticipate playing Powerball only when the jackpot reaches a high level.

Our overall revenue, in spite of the dip in on-line revenue, remains nearly constant, declining 0.3% for the fiscal year.

Our financial picture, although declining slightly, is positive in some respects. Our Scrarch ticket revenue remains a bright spot, and a product area that the Lottery can take steps to continue to increase. Because of costs in ticket production related to a new on-line lottery system, expenses have increased. This new system was necessary because our contract with our previous vendor came to an end, and by law, we had to go out to bid. However, these system expenses, although significant, will position the Lottery well into the future to be able to adequately meet the needs of our retailers and players.

As we look forward to fiscal year 2001, "change" will continue to be the focus of the Montana Lottery. We will continue to make product and system improvements with the dual goals of improving customer service for our retailers and players, and maximize revenues for the State of Montana.

Sincerely,

Gerald J. LaChere

Gerald J. LaChere
Director

Montana Lottery

Lottery Commission

Robert Crippen, Chair
Montana Lottery Commission

The Montana Lottery Commission consists of five members appointed by the Governor. By law, one member must be a law enforcement officer, one must be an attorney licensed to practice law in Montana, and one must be a certified public accountant. The Lottery Commission is charged with setting policy for the operation of the Lottery, determining types and forms of lottery games, ensuring the security and integrity of the Lottery, and maximizing revenue paid to the State. The members are appointed to staggered four-year terms.

The Montana Lottery celebrated thirteen years of operation in June 2000, ending the year by transferring a total of $5.8 million for the year to the State of Montana General Fund. This makes our total transfer to State programs over the past thirteen years of $85.6 million. In the meantime, the Lottery has paid over $180 million in prizes, and $20.8 million to the retailers who sell our products.

The Lottery Commission is pleased with the course the Lottery Director and staff have pursued. We commend them for their hard work over the past thirteen years. We face many challenges ahead, and with the dedication and enthusiasm of the Lottery staff, the network of retailers who sell our products, and the Montana residents who participate in the Lottery games, we believe the Lottery will continue to meet its mandate of maximizing revenues for Montana.

Cliff Brophy, Columbus

Becky Erickson, Glasgow

Carol Thomas, Great Falls

Not Pictured, Tom Keegan, Helena

Scratch Tickets

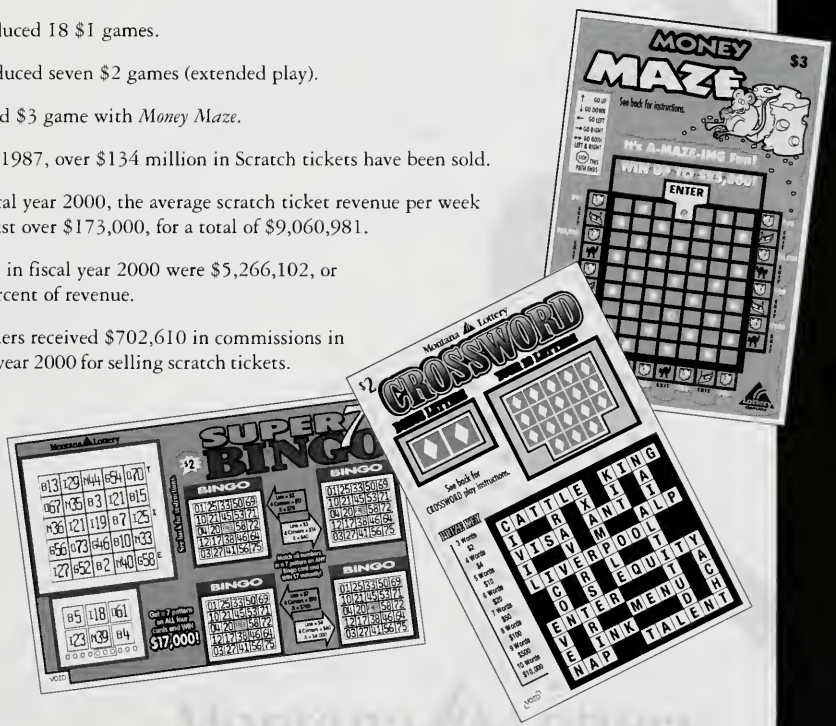
Scratch games are played by removing the latex covering to reveal game symbols. A player can determine immediately if they have won.

The Montana Lottery currently markets Scratch tickets to over 600 retailers who offer them for sale in grocery stores, convenience stores, and a variety of other locations. We maintained the practice of a multiple game strategy, in which a variety of games are offered which are distinguished by unique themes, graphics, play styles and prize structures. In addition to the variety, customers see frequent introductions of new games. The variety, combined with frequent new games, contributed to the growth over the past two years in Scratch ticket sales.

Most retailers display and sell eight to twelve games at a time. *Bingo* and *Crossword* have become strong selling games, averaging almost $82,000 per week. Both games are sold at $2, and are called "extended play" games, because the play area is larger and takes longer to uncover. Some players appreciate the perceived value of the "extended play" games, which also offer a higher top prize, generally in the range of $10,000.

In fiscal year 2000, Scratch tickets sold for $1, $2, and $3, depending on the game. The Lottery introduced 27 different games

- Introduced 18 $1 games.
- Introduced seven $2 games (extended play).
- Started $3 game with *Money Maze*.
- Since 1987, over $134 million in Scratch tickets have been sold.
- In fiscal year 2000, the average scratch ticket revenue per week was just over $173,000, for a total of $9,060,981.
- Prizes in fiscal year 2000 were $5,266,102, or 58 percent of revenue.
- Retailers received $702,610 in commissions in fiscal year 2000 for selling scratch tickets.



Lottery Product Highlights

POWERBALL

- Introduced in April 1992 and redesigned in 1998.
- Currently operated in conjunction with twenty other lottery jurisdictions.
- Players pick five numbers from a field of 49 plus one number, the Powerball, from a field of 42 numbers. They can also play "Quick Pick" where the computer selects some or all of the numbers.
- The jackpot begins at a minimum $10 million, and grows until someone matches all five white numbers plus the Powerball.
- There are nine ways to win playing Powerball.
- Overall odds of winning are approximately 1:35.
- Odds of winning the jackpot are approximately 1:80 million
- In fiscal year 2000, Powerball revenue totaled $13.1 million, or 44 percent of total revenue.
- There were six $100,000 winning tickets in Montana in Fiscal Year 2000.
- Another 44 tickets matched four of five plus the Powerball to win $5,000,
- There were an additional 374,387 tickets sold in Montana that won $3 through $100.
- Prize expense for the year in Powerball was almost $6.3 million for 48 percent of Powerball revenue.

MONTANA CA$H

- Introduced in May 1991.
- Montana Cash is the only Montana-specific on-line product, and offers a $20,000 minimum jackpot.
- Players pick five numbers from a field of 37. "Quick Pick" option, where the computer selects some or all of the numbers, is also available.
- Players receive two plays for $1.
- Overall odds of winning are approximately 1:43.
- Odds of winning the jackpot are approximately 1:217,949.
- Montana Cash revenue for the year totaled almost $4.3 million, or 14 percent of total revenue.
- In fiscal year 2000, 20 Montana Cash players matched all five numbers drawn to win or share jackpots ranging from $20,000 to $170,000.
- Another 3,179 tickets were sold that matched four of five numbers drawn to win $200.
- There were 96,107 winning tickets matching three of five numbers to win $5.
- Prize expense in Montana Cash for fiscal year 2000 totaled almost $2.3 million, or 54 percent of revenue.

WILD CARD 2

- Played in Montana, Idaho and South Dakota.
- Players select five numbers out of 31, or they can "Quick Pick" where the computer selects some or all the numbers. Players can also select or Quick Pick the Wild Card—a Jack, Queen, King or Ace from one of the four suits—Diamonds, Clubs, Hearts or Spades.
- Overall odds of winning a prize in Wild Card are 1:6.
- Odds of winning the jackpot prize, which starts at a minimum of $100,000, are 1:1,359,288.
- Wild Card revenue for the year totaled almost $2.7 million, or nine percent of total revenue.
- There are seven ways to win playing Wild Card.
- In July 1999, one player from Great Falls matched all five winning numbers plus the Wild Card to win a $664,000 jackpot.
- Another 26 players matched all five winning numbers, but not the Wild Card, to claim the $5,000 second-tier prize.
- There were 433,615 tickets sold in Montana that won prizes ranging from $1 to $500.
- Prize expense in Montana totaled almost $1.4 million or 52 percent of revenue.

Cash 4 Life MONTANA

- Played every day in Montana and ten other lottery jurisdictions.
- Players can select four numbers from 00 to 99, or they can "Quick Pick" for one chance to win $1000 a week for life. The computer then selects an additional 14 sets of four numbers:
    - Two sets for a chance to win $100,000
    - Four sets for a chance to win $50,000
    - Eight sets for a chance to win $25,000
- Overall odds of winning a prize in Cash 4 Life are 1:9.9.
- Odds of winning the Cash 4 Life top prize are 1:3,921,225
- Cash 4 Life revenue for the year totaled $773,470 or three percent of total revenue.
- In September 1999, one player from Swan Lake matched four winning numbers to win $50,000.
- A ticket worth $50,000 was sold in Great Falls in December 1999.
- A Billings resident won $100,000 in January 2000.
- Another Billings resident claimed $50,000 in February 2000.
- There were 81,020 tickets sold in Montana that won the minimum $1 prize.
- Another 1,166 tickets won the $20 prize.
- Prize expense in Montana totaled just over $372,000 or 48% of Cash 4 Life revenue.

Independent Auditor's Report

INDEPENDENT AUDITORS' REPORT

September 1, 2000

To the Commissioners
Montana State Lottery
Helena, Montana

We have audited the accompanying financial statements of Montana State Lottery (Lottery), an enterprise fund of the State of Montana, as of and for the years ended June 30, 2000 and 1999. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note A, the financial statements present only the Montana State Lottery and are not intended to present the financial position of the State of Montana and the results of its operations and cash flows of its proprietary fund types and non-expendable trust funds in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Montana State Lottery, an enterprise fund of the State of Montana, as of June 30, 2000 and 1999, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 1, 2000 on our consideration of the Montana State Lottery's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Galusha, Higgins & Galusha, PC

GALUSHA, HIGGINS AND GALUSHA, PC
Certified Public Accountants

Balance Sheets
June 30,

ASSETS

	2000	1999
CURRENT ASSETS		
Cash and cash equivalents	1,748,886	3,056,419
Accounts receivable, less allowance for doubtful receivables of $668 in 2000 and $-0-in 1999	682,506	1,751,681
Due from other funds	2,236	4,326
Inventory	1,121,826	744,266
Cash collateral – security lending transactions	79	161,905
Other current assers	26,084	33,669
Total currenr assets	3,581,617	5,752,266
PROPERTY, PLANT AND EQUIPMENT		
Furniture, fixtures and equipment	4,248,387	4,432,032
Accumulated depreciation	(997,780)	(577,547)
	3,250,607	3,854,485
INTANGIBLE ASSETS		
Software, net of accumulated amortization	944,643	1,108,929
Other intangibles	12,219	5,985
	956,862	1,114,914
OTHER ASSETS		
Long-term receivable	2,102,186	2,014,421
	9,891,272	12,736,086

LIABILITY AND FUND EQUITY

CURRENT LIABILITIES		
Accounts payable	624,438	731,944
Accrued interest payable	38,085	46,456
Estimated prize liability	1,090,010	1,527,180
Transfer obligations to general fund	1,505,918	2,842,718
Liability under security lending transactions	79	161,906
Due to other state agencies	81,187	80,754
Other current liabilities	147,840	74,671
Currenr portion of long term debt	952,741	905,482
Total current liabilities	4,440,298	6,371,111
LONG-TERM LIABILITIES		
MUSL prize liability	1,873,671	1,830,143
Note payable	3,167,088	4,119,829
Accrued compensated absences	172,532	177,320
	5,213,291	6,127,292
	9,653,589	12,498,403
FUND EQUITY		
Retained earnings	-	-
Contributed capital	237,683	237,683
	9,891,272	12,736,086

The accompanying notes are an integral part of these financial statements.

Statements of Revenues, Expenses and Changes in Retained Earnings

Statements of Revenues, expenses and changes in retained earnings
Year ended June 30,

	2000	1999
OPERATING REVENUES		
Instant ticket games	9,060,981	7,314,666
On-line games	20,838,828	22,677,234
Miscellaneous	76,863	83,744
Total operating revenues	29,976,672	30,075,644
COST OF TICKET REVENUES		
Instant ticket prize expense	5,266,102	4,063,088
On-line ticket prize expense	10,309,291	10,987,388
Retailer commission	1,745,566	1,684,852
On-line vendor fees	2,496,870	2,708,662
Cost of tickets sold	625,654	571,254
Total cost of ticket revenues	20,443,483	20,015,244
Net operating revenues	9,533,189	10,060,400
OPERATING EXPENSES		
Advertising	603,239	544,162
Other communications	124,705	138,693
Advertising production	132,005	134,221
Audit fees	41,307	42,843
Other contractual services	142,545	216,088
Depreciation and amortization	758,527	231,640
Management fees	122,851	119,569
Multi-state operating fees	109,746	84,284
Other	75,402	68,518
Personal services	1,258,234	1,240,582
Repairs and maintenance	47,526	55,396
Supplies and materials	166,931	132,884
Utilities and rent	100,013	95,844
Travel	27,089	31,910
Total operating expenses	3,710,120	3,136,634
OPERATING INCOME	5,823,069	6,923,766
NON-OPERATING REVENUES (EXPENSES)		
Interest income	278,386	299,653
Interest expense	(231,724)	(46,456)
Security lending income	5,921	10,804
Security lending costs	(5,687)	(10,295)
Gain (loss) on disposal of fixed assets	(28,980)	163
Total non-operating revenues (expenses)	17,916	253,869
INCOME BEFORE OPERATING TRANSFERS	5,840,985	7,177,635
OPERATING TRANSFERS OUT		
General fund	5,840,985	6,780,404
Study of the Socioeconomic Impacts of Gambling Fund	-	47,231
Total operating transfers out	5,840,985	6,827,635
INCOME BEFORE CUMULATIVE AFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE AND EXTRAORDINARY ITEM	-	350,000
CUMULATIVE EFFECT ON PRIOR YEARS OF ACCOUNT CHANGE		
EXTRAORDINARY ITEM	-	(350,000)
NET INCOME (LOSS)	-	-
Retained earnings, beginning of year	-	-
Retained earnings, end of year	-	-

The accompanying notes are an integral part of these financial statements.

Cash Flows
June 30,

	2000	1999
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from sales	31,119,016	29,214,591
Cash paid to suppliers for goods and services	(6,976,426)	(6,800,502)
Cash paid to employees	(1,263,022)	(1,246,535)
Cash paid for prizes	(15,969,035)	(14,970,318)
Net cash provided by operating activities	6,910,533	6,197,236
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Operating transfers out:		
General fund	(7,177,785)	(6,196,870)
Study of Socioeconomic Impact of Gambling Fund	-	(47,231)
Net cash used by non-capital financing activities	(7,177,785)	(6,244,101)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of fixed assets	(23,337)	-
Interest paid	(240,095)	-
Payments on long-term borrowing	(905,482)	-
Proceeds from sale of fixed assets	3,995	1,724
Net cash provided (used) by capital and related financing activities	(1,164,919)	1,724
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest Income	124,404	155,830
Security lending income	5,921	10,804
Security lending costs	(5,687)	(10,295)
Net cash provided by investing activities	124,638	156,339
NET INCREASE IN CASH AND CASH EQUIVALENTS	(1,307,533)	111,198
Cash and cash equivalents, beginning of year	3,056,419	2,945,221
Cash and cash equivalents, end of year	1,748,886	3,056,419
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	5,823,069	6,923,766
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	758,527	231,640
Extraordinary loss	-	(350,000)
Changes in net assets and liabilities:		
(Increase) decrease in accounts receivable	1,069,175	(800,706)
Decrease in due from other state agencies	2,090	12,323
(Increase) in inventory	(377,560)	(429,819)
Decrease other current assets	7,585	13,823
Increase in long-term receivable	(87,767)	(133,774)
Interest received included in long term receivable	153,982	143,824
(Increase) decrease in other intangible assets	(6,234)	7,261
Increase (decrease) in accounts payable	(107,506)	474,240
Increase (decrease) in lottery prizes payable	(393,642)	154,392
Increase (decrease) in other current liabilities	73,169	(67,754)
Increase in due to other state agencies	433	19,073
(Decrease) in compensated absences payable	(4,788)	(1,053)
Net cash provided by operating activities	6,910,533	6,197,236

Non cash transactions from capital and related financing activities in 1999 consist of financing the cost of computer equipment and software through a long term note payable of $5,025,311 to Norwest Investment Services, Inc. There were no such activities in 2000.

The accompanying notes are an integral part of these financial statements.

NOTE A Summary of Significant Accounting Policies

Organization - The Montana State Lottery (hereafter referred to as the Lottery) was created in November 1986 by a referendum vote of the people of Montana. Section 23-7-101, Montana Code Annotated (MCA) establishes the provision of the code under which the Lottery operates. The Lottery is operated by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the type and forms of lottery games, set ticket prices, determine the number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games with other states, and prepare financial reports. The Lottery is attached to the Montana Department of Commerce for administrative purposes.

Disposition of revenue is a minimum of 45 percent for prizes and a maximum of 10 percent for commission to sales agents. The remaining revenue, less operating expenses, is transferred to the Montana State General Fund. Section 23-7-401(5), MCA, states that for the purposes of funding a study of the socioeconomic impacts of gambling, $100,000 of Lottery net revenue may be appropriated during the biennium ending June 30, 1999. $47,231 of net revenue was utilized to fund the study during fiscal year 1999, and is reflected in the financial statements as an operating transfer out.

Reporting Entity - The Lottery is included in the State of Montana's financial statements as an enterprise fund. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Lottery's financial statements as a reporting agency.

Basis of Accounting - The Lottery utilizes the accrual basis of accounting and is classified as an enterprise fund of the governmental proprietary fund type. Enterprise funds account for operations similar to private business enterprises where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or where the Legislature has decided that periodic determination of revenue earned, expenses incurred or net income is appropriate.

Revenue Recognition - Sales of instant lottery tickets are made to licensed retailers who market the tickets to the public on a commission basis. Revenue is recognized when tickets are activated by retailers. Tickets activated, but not sold by retailers, may be returned for credit. Sales are reduced for estimated ticket returns.

Sales of on-line lottery tickets are made to licensed retailers who market the tickets through the use of computerized terminals on a commission basis. Revenue is recognized on drawing dates. Tickets sold in advance of future drawing dates are recorded as deferred revenue until the ticket becomes valid for a drawing.

Cash and Cash Equivalents - Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investments pool, cash deposited with banks and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily.

Inventory - Inventories consist of tickets and supplies. Ticket inventory includes instant lottery tickets that are carried at cost using the specific identification method. Tickets are charged to cost of sales when activated.

Unsold tickets are charged to cost of sales upon the end or cancellation of the related game. Supply inventory is carried at cost and expensed as used.

Prizes - Prize expense is recognized based on a predetermined prize structure for each instant ticket and on-line game. Free tickets are recorded as a reduction in revenue and not as prize expense.

NOTE A Summary of Significant Accounting Policies (Continued)

Unclaimed Prizes - Prizes for the on-line games, Powerball, Wild Card, Cash 4 Life and Montana Cash, must be claimed within six months after the appropriate draw date. Prizes for instant games must be claimed within six months of the announced end of each game. The unclaimed prize amounts are taken as a reduction in the Lottery Prizes Payable liability and the Prize Expense and are transferred to the State of Montana General Fund as a portion of the quarterly transfer. The combined amounts of unclaimed prizes for on-line games were $591,469 and $490,243 and for the instant games were $387,666 and $316,667 for the fiscal years ended June 30, 1999 and 2000, respectively.

Intangible Assets - Intangible assets consist of the following:

Software represents the amortized cost of software purchased in 1999. This software had an original cost of $1,150,000 and is being amortized over seven years.

Other intangibles represent the per ticket cost paid to Autotote Lottery Corporation for advance on-line ticket sales. These ticket sales, also referred to as deferred revenue, represent tickets sold prior to June 30, 2000 and 1999 for drawings held subsequent to fiscal year-end.

Fixed Assets - Fixed assets are recorded at cost. Donated fixed assets are recorded at their estimated fair market value at the date of donation. Ordinary maintenance and repairs are charged to operations as incurred; major renewals and betterments are capitalized. Upon disposition or retirement of fixed assets, the cost and related accumulated depreciation or amortization is removed from the accounts. Gain or loss on disposal is reflected in nonoperating revenues and expenses. Depreciation and amortization are calculated on a straight-line basis over estimated useful lives of two to ten years. The Lottery conforms to the State of Montana capitalization threshold for recording fixed assets. This threshold is $5,000.

Contributed Capital - Contributed capital represents equity acquired through contributions from vendors and the State of Montana.

Compensated Absences - State employees earn vacation leave ranging from fifteen to twenty-four days per year based on years of service. Vacation leave may be accumulated to a total not to exceed twice the maximum number of days earned annually. Sick leave accumulates at a rate of twelve days per year with no maximum accumulation. Upon retirement or termination, an employee is paid for 100 percent of unused vacation leave and 25 percent of unused sick leave.

NOTE B Cash and Cash Equivalents

Cash and cash equivalents consist of the following:

June 30	2000	1999
Short-term investment pool	$1,022,827	$3,028,189
Cash on deposit with State Treasurer	715,909	18,080
Cash in revolving deposit account	10,000	10,000
Petty cash	150	150
	$1,748,886	$3,056,419

The Montana State Lottery participates in the Montana Board of Investments Short Term Investment Pool (STIP). STIP balances are highly liquid investments with maturities of 397 days or less. There are no legal risks that the Board of Investments is aware of regarding any STIP investments. The bank balance of the revolving deposit account was $16,848 and $11,478 at June 30, 2000 and 1999, respectively, and was covered by federal depository insurance. The carrying amount reported in the balance sheet for cash and cash equivalents approximates the fair market value.

NOTE C Other Current Assets

Other current assets consist of the following:

June 30	2000	1999
Prepaid expenses	$ 21,784	$ 27,945
Employee travel advances	4,300	5,724
	$26,084	$33,669

NOTE D Fixed Assets

A summary of changes in fixed assets for the Montana Lottery for the year ended June 30, 2000 is as follows:

	Balance 6/30/99	Additions	Deletions	Balance 6/30/00
Equipment	$4,432,032	$ 23,338	$206,983	$4,248,387
Accumulated depreciation	$ 577,547	$594,241	$174,008	$ 997,780

NOTE E Multi-State Lottery Association

Joint Venture Association - In November 1989, the Montana State Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. The Lotto*America/ Powerball game, Wild Card game and Cash 4 Life game are presently the only games operated jointly by the members. Each lottery participating in MUSL is represented on the Board of Directors.

Prize Reserve Fund Receivable/Payable - As a member of the MUSL, the Lottery is required to contribute to various prize reserve funds maintained by MUSL. The contributions are to be used to fund unanticipated prize claims. All funds remitted and the related interest earnings will be returned to the Lottery upon leaving the association, less any portion of unanticipated prize claims, which may have been paid from the fund.

The Lottery contributes to the reserve fund through the set-aside for prizes. Payments made to the reserve fund are considered a portion of the prize expense associated with the on-line game.

During 1990, the MUSL Board created the unreserved accounts to record interest earned on the various prize reserve funds when the prize reserve fund balance is not below the predetermined ceiling amount. The amounts in the unreserved accounts may be used at the Board's discretion.

The long-term receivable balance of $2,102,186 and $2,014,421 at June 30, 2000 and 1999, respectively, represents the Lottery's share of the MUSL prize reserve fund that had a balance of $102,899,124 and $97,269,759 for 2000 and 1999,respectively. The long-term liability balance of $1,873,671 and $1,830,143 at June 30, 2000 and 1999, respectively, represents the Lottery's share of the total estimated prize liability.

Lotto*America Prizes and Investments - Prizes awarded to Lotto*America grand prize winners are paid in twenty annual installments funded by investments in United States Treasury zero coupon bonds. Bonds purchased on behalf of Montana source winners are held in trust by MUSL with the Montana State Lottery as beneficiary. As the bonds mature, the proceeds are forwarded to the Montana State Lottery and distributed to the grand prize winners on the anniversary date of each win.At June 30, 2000 and 1999, MUSL held United States Government zero coupon bonds in trust for the Montana State Lottery winners with respective par values of $65,581,948 and $70,789,948 and respective market values of $44,379,780 and $47,272,236.

The Montana State Lottery has eight Lotto*America/Powerball/Tri-West winners. The combined total future prize payments owed is $65,581,000 and $70,789,000 at June 30, 2000 and 1999, respectively. Total annual payments due over each of the next five years is $5,208,000 annually and $39,541,000 thereafter. The present value of future

NOTE E MULTI-STATE LOTTERY ASSOCIATION (CONTINUED)

prize payments approximates the current market value of the bonds held in trust for the Montana State Lottery winners.

Multi-State Lottery Association Financial Position - Information related to the Multi-State Lottery Association's audited financial statements is as follows:

June 30	2000	1999
Total assets	$1,433,307,032	$1,585,325,696
Total liabilities	1,433,128,671	1,585,096,945
Total net assets	178,361	228,751
Total liabilities and net assets, unrestricted	$1,433,307,032	$1,585,325,696
Total revenues	$ 2,865,781	$ 2,713,805
Total expenses	2,916,171	2,748,587
Decrease in unrestricted net assets	$ (50,390)	$ (34,782)

NOTE F ESTIMATED PRIZE LIABILITY

The estimated prize liability represents the Lottery's estimate of prizes payable related to games in process at year-end based on the predetermined prize structure of each outstanding game.

NOTE G OBLIGATION TO TRANSFER FUNDS

The Montana State Lottery is required to transfer its net revenue to the Montana State General Fund. This change was enacted through the passage of SB 83 by the 1995 Legislature and signed into law by Governor Racicot in April 1995. Transfer obligations outstanding at June 30, 2000 and 1999 were $1,505,918 and $2,842,718, respectively.

NOTE H OTHER CURRENT LIABILITIES

Other current liabilities consist of the following:

June 30	2000	1999
Property held in trust	$ 1,500	$ 3,000
Deferred on-line revenue	146,340	71,671
	$147,840	$74,671

NOTE I LONG-TERM LIABILITES

Long-term liabilities consist of the following:

	June 30			
	Current	Long-Term	2000 Total	1999 Total
Prize liability Multi-State Lottery Association		$1,873,671	$1,873,671	$1,830,143
Accrued compensated absences		172,532	172,532	177,320
Note Payable-Norwest Investment, interest rate 5.12% for 5 years requiring quarterly payments of $286,394.30.	$952,741	3,167,088	4,119,829	5,025,311
	$952,741	$5,213,291	$6,166,032	$7,032,774

Future scheduled principal maturities of the long-term note payable are as follows:

2001	$ 952,741
2002	1,002,466
2003	1,054,786
2004	1,109,836
Totals	$4,119,829

NOTE J Leases

The Lottery leases its office, administrative and warehouse facilities under a lease agreement expiring February 2002. Rent expense under operating leases charged to operations was $78,000 for the years ended June 30, 2000 and 1999.

NOTE K Employee Benefit Plans

Pension Plan - The Lottery participates in the Public Employees Retirement System (PERS). PERS is a statewide mandatory cost-sharing multiple employer defined benefit retirement plan which covers all employees. The plan is established under State law and is administered by the State of Montana. The plan provides retirement, disability, and death benefits to plan members and beneficiaries.

The plan issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained from the following address: Public Employees Retirement System, Montana Public Employees Retirement Administration, P.O. Box 200131, 1712 Ninth Avenue, Helena, MT 59620-0131, (406) 444-3154.

Contribution rates for the plan are required and determined by State law. The contribution rates for fiscal years 2000, 1999 and 1998, expressed as a percentage of covered payroll, were 6.9%, 6.9% and 6.8%, respectively, for both the employer and the employees.

The amounts contributed to the plan during the years ended June 30, 2000, 1999 and 1998, were $128,372, $127,111 and $129,256, respectively, and were equal to the required contributions for each year.

Deferred Compensation Plan - The Lottery's permanent employees are eligible to participate in the State of Montana's deferred compensation plan. The plan is administered by Benefits Corporation on behalf of Great West Life Insurance Company through a contract with the State of Montana. The amount of compensation deferred is not available to employees until termination, retirement, death, or unforeseen emergency. All amounts are deferred under the plan created under Internal Revenue Code Section 457 and Title 19, chapter 50, Montana Code Annotated (MCA). Assets of the deferred compensation plan are required to be held in trusts, custodial accounts or insurance company contracts for the exclusive benefit of participants and their beneficiaries.

NOTE L Related Party Transactions

During the ordinary course of business, other State agencies provide certain services and supplies to the Lottery. During 2000 and 1999, total payments to other State agencies were approximately $317,000 and $326,000, respectively.

NOTE M Commitments and Contengencies

Instant Tickets - The Lottery has an agreement with Oberthur to print instant game tickets. The agreement expires June 30, 2001.

Maintenance Contract - The Lottery had an agreement with Stratus Computer, Inc. to provide for computer hardware and software maintenance. The agreement provided for quarterly payments of $9,587. The Lottery exercised its option to terminate the agreement effective March 1, 2000.

On-line Vendor - Lottery is contracted with Autotote Lottery Corporation to provide for the operation of an on-line gaming system through March 30, 2006. The estimated total contract price is approximately $24 million over the seven-year contract.

Advertising - The Lottery signed a contract with Banik & Associates to provide advertising services for $8,400 per month through December 2001.

Independent Observation of Drawings - Lottery is committed to Henry Fenton, CPA, to observe Montana Cash and other special drawings. The term of the contract is for one year ending June 30, 2001. Compensation will not exceed $8,000.

NOTE M Commitments and Contengencies (Continued)

Audit of Financial Statements - The Lottery is party to a contract with Galusha, Higgins and Galusha, PC, an independent accounting firm, to audit the Lottery's annual financial statements. The yearly contract was finalized on June 7, 1999, and is renewable annually for six years with the consent of all parties. Compensation for the year ended June 30, 2000, will not exceed $10,500.

Prize Contingencies - Certain Big Spin prizes awarded are payable to the winners in annual installments spanning seventeen to twenty years with the first payment being made by the Lottery. The Lottery has entered into agreements with an insurance carrier under which purchased annuities will provide the required level of payments corresponding to the Lottery's obligation to these prize winners. Because it is the intent of the Lottery that the insurance carrier will make future installment payments directly to each prize winner, neither the present value of the annuities nor the present value of the future payments are reflected in the accompanying financial statements. The Lottery would be liable for such future payments in the gross amount of $1,734,559 and $1,984,559 June 30, 2000 and 1999, respectively, if the insurance carrier defaulted on their payments.

NOTE N Extraordinary Item

The Montana Lottery awarded a seven-year contract to Autotote Lottery Corporation (ALC) for the implementation and operation of an on-line lottery system. Automated Wagering International (AWI), who also bid on the contract, contested the award of the contract to ALC. The Montana Lottery, ALC and AWI settled the protest by AWI in a settlement agreement dated February 1999. The agreement required a $500,000 payment to AWI to discharge and release all parties from any further action related to the protest. The settlement dictated that ALC contribute $150,000 to the Montana Lottery to be applied to the Montana Lottery's required $500,000 payment to AWI. $350,000 was paid to AWI from Lottery funds on February 26, 1999, and $150,000 was paid on June 25, 1999.

NOTE O Risk Management/Public Entity Risk Pool

The Montana State Lottery contributes to the Group Employee Comprehensive Medical and Dental Plan and the Property and Casualty Insurance plans of the State of Montana. Details of these plans can be found in the State of Montana Comprehensive Annual Financial Report.

NOTE P Advertising Costs

Advertising costs are expensed in the year they are incurred.

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

September 1, 2000

To the Commissioners
Montana State Lottery
Helena, Montana

We have audited the financial statements of Montana State Lottery (Lottery), an enterprise fund of the State of Montana, as of and for the year ended June 30, 2000, and have issued our report thereon dated September 1, 2000. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended for the information of the Lottery's Commissioners, management and the Legislative Audit Committee. However, this report is a matter of public record and its distribution is not limited.

Galusha, Higgins & Galusha, PC

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